IT 00-0034-GIL 03/28/2000 VOLUNTARY DISCLOSURE AGREEMENTS

General Information Letter: Taxpayers desiring relief from liability for prior tax years for which no returns were filed should apply for voluntary disclosure relief.

March 28, 2000

Dear:

This is in response to your letter dated February 24, 2000. Given the nature of your inquiry and the information you provide, I am responding with a General Information Letter. This is not to be taken as a statement of Department policy or as a binding ruling by the Department. As general information gathered in response to your particular questions, however, I hope that it is helpful to you. *See* 86 Ill. Adm. Code 1200.120(b) and (c), which can be obtained at the following website:

http://www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter you have stated the following:

> We are writing on behalf of a client (the "Company") that conducts certain activities in the State of Illinois (the "State"). The Company, an "S" corporation, currently is not registered with the State for sales/use or income tax purposes (and does not make such filings) and believes that, under current law, it is not legally required to do so. Nevertheless, the Company and its shareholders (the "Shareholders") are concerned with the current continuing uncertainty of the law in this area. To eliminate this uncertainty, the Company is willing to collect taxes on non-exempt sales into the State and the Shareholders are willing to pay income tax with respect to their pro-rata share of the Company's apportioned S corporation income, provided the State agrees that the Company and the Shareholders do not have sales/use or income tax liabilities with respect to operations of the Company for prior periods. The Company and the Shareholders have asked us to contact you on a confidential basis to explore this possibility.
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> 1. Facts:
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> The Company is an "S" corporation with its operations and headquarters located outside the State. The Shareholders are not residents of the State and are not otherwise required to pay income tax to the State. The Company primarily manufactures and sells machines that are used in the food processing industry. All of the Company's manufacturing process occurs outside of the State. The Company's only contacts with the State are, as described below, sales of machinery into the State and minimal (perhaps less than annual) employee start-up and service visits to the State.
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> With respect to sales activity, the Company solicits orders of its machinery through national advertisements, trade magazines, independent contractors and employee sales persons. All machinery orders are accepted and processed at the Company's headquarters outside the State and the purchased machines are then shipped to customers via common carrier. For the Company's last four fiscal years, the gross sales of machines and replacement parts to customers in the State were as follows:

Year:	1996	1997	1998	1999
Sales:	$718,314	$792,705	$658,658	$979,193

(These figures, which are listed in terms of total *gross* sales, do not account for (a) sales that may be exempt due to the nature of the property sold (and we note in this regard that the items that are sold are machines); (b) sales for which property was shipped to another state; (c) credit memos, reflecting an adjustment for returned merchandise; (d) sales for which customers self-reported use taxes; (e) sales for resale; and (f) sales to tax-exempt entities. When these items are taken into account, it is possible that the potentially taxable gross receipts would be reduced substantially, perhaps even to zero.)

On very rare occasions, a customer in the State has requested that the Company, in connection with a sale of machinery, provide in-person start-up instruction. The Company believes that, during most years, no start-up visits occurred in the State and that, in those years during which these visits occurred, there were only one or perhaps two such visits. Such visits lasted only one day or a fraction thereof. The start-up visits were ancillary to the solicitation of sales, done as part of the Company's effort to solicit orders (and obtain repeat orders) from customers.

On the rare occasions when the company has been unable to fully resolve a customer inquiry concerning machinery operations via telephone from its out-of-state corporate headquarters, the Company has, as an accommodation to the customer and when deemed appropriate by the Company, sent an employee from the Company's headquarters to the customer's office to resolve the matter. The Company estimates that during the last four years, an average of two to four visits per year occurred for this purpose. Prior thereto, the Company believes (although it is difficult, due to the passage of time, to verify) that even fewer such visits occurred. These visits lasted one day or a fraction thereof. The average annual gross revenue derived by the Company from these services in the State during the last four years has been only $28,945.

Except as noted above, the Company believes that it does not have and has not had sales, use, or income tax nexus in the State. Virtually all the classic indicia of nexus are absent, meaning that the only question is whether the sales and minor service activities, either by themselves or in combination, create nexus. The Company believes that, under current law, the answer to this question is no. See Quill Corp. v. North Dakota, 112 S. Ct. 1904 (1992) and Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1976) (holding that "substantial" nexus is required before a state can impose tax collection and payment responsibilities). Nevertheless, we recognize that this conclusion is not completely free from doubt. Because of this uncertainty, the Company and the Shareholders have asked that we write to you to attempt to reach an agreement that would remove all doubt on the nexus issue. As previously stated, their proposal is that the Company would register with the State to collect use taxes on the sale of non-exempt property on a forward-going basis and that the Shareholders would begin filing income tax returns, in exchange for the Department's agreement that the Company and the Shareholders do not have liability with respect to the Company's operations for prior periods.

Response

Your Sales and Use Tax issues are being addressed by a different section of IDOR Legal Services. This letter is intended to answer any questions regarding the Illinois Income Tax Act (IITA).

I am enclosing the forms needed to apply for a Voluntary Disclosure Agreement. Your discussion of the law regarding nexus for taxation is generally accurate. You conclude by noting that there is some room for doubt on the issue. I would add to your discussion only the case of Wisconsin v. Wrigley, 112 S. Ct. 2447 (1992), in which the United States Supreme Court ruled that sales activities supplemented by various types of customer services were sufficient to establish nexus for Wisconsin's income tax.

As stated above, this is a general information letter that does not constitute a statement of policy that applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). Please do not hesitate to call me at (217) 782-2844 if you have further questions.

Sincerely,

Kent R. Steinkamp
Staff Attorney -- Income Tax